

# **Secured Transaction Law**

## ***-An Important Economic Development Tool for Tribes-***

Sue Woodrow  
Community Affairs Managing Project Director  
Federal Reserve Bank of Minneapolis, Helena Branch

### **I. What is *secured transaction law* and why is it important?**

- a. Market economies depend on the ability of organizations and individuals to access credit at affordable rates and terms, and encourage investment
- b. To effectively enable access to credit by businesses and individuals, rules are needed to govern “lender–borrower / creditor-debtor” transactions and relationships, including systems for collecting debts and bankruptcy systems for terminating the collection of unpaid debts
- c. Three basic systems in modern market economies have developed for collecting debts
  - i. *Unsecured lending* – a system that does not depend on collateral to secure a creditor’s interest (collateral = secondary source of payment)
  - ii. ***Secured lending*** – a system that uses “personal” property (movable or intangible things) as collateral to secure a creditor’s (lender or unpaid seller) interest
  - iii. *Mortgage lending* – a system that uses “real” property (land or things affixed to land) as collateral to secure a creditor’s interest
- d. *Secured lending /secured transaction law* – Almost all developed private enterprise economies have laws that provide rules governing secured loans or transactions. These are the rules and procedures for borrowing and lending, how risk is allocated among competing creditors, and how risk is managed upon default of payment against debt. (*In a private enterprise economy, the primary source of funding or credit is not the government but individuals, banks and other private lenders*)
- e. All states of the United States have enacted in some form or another the Uniform Commercial Code (UCC), which was developed in the 1940s for the purpose of establishing a reasonably consistent legal environment for commercial transactions throughout the U.S. The near uniform adoption of the UCC has enabled cross-border business between states to take place efficiently and cost-effectively. The UCC is comprised of 12 “codes” or articles. (Article 1 - Definitions and General Rules; Article 2 - Sales; Article 2A – Leases; Article 3 - Negotiable Instruments; Article 4 - Bank Collections; Article 4A - Funds Transfers; Article 5 - Letters of Credit; Article 6 - Bulk Sales; Article 7 - Documents of Title; Article 8 - Investment Securities; *Article 9 - Secured Transactions*)
- f. Developing and transition economies around the world have made adoption of secured transaction laws a priority to attract outside investment and to kickstart economic development, recognizing that earlier efforts to promote economic development have been hindered by the lack of secured lending legislation and

pledge registration systems (i.e., Albania, Russia, Georgia, Kazakhstan, Kyrgyz Republic, Uzbekistan, Azerbaijan, China, Indonesia, Thailand)

## II. Why are secured transaction laws important in Indian Country?

- a. Need and desire for successful and sustainable economic development in Indian Country with the goal of strengthening sovereign nations
- b. Fundamental to this goal is the need to create an environment in Indian Country that encourages lenders and other non-tribal businesses to do business not only with tribes but also tribal members and non-tribally owned Indian businesses, and that protects the interests of all parties engaged in financial transactions
- c. Key to this are the governing and legal infrastructures that not only support and strengthen the effective exercise of tribal sovereignty, but that also satisfy the fears that have been routinely expressed by prospective lenders, business partners and investors. Faced with uncertain or no rules, lenders may be unlikely to lend and investors are unlikely to invest
- d. Commercial laws provide this certainty when they are respected and supported by tribal courts and tribal governments
- e. Benefits
  - i. Tribes exercise sovereignty by setting the rules governing business transactions
  - ii. Creates certainty and predictability about the rules
  - iii. Provides notice and consistent application of rules specific to the tribe or tribes
  - iv. May encourage more lenders to do business with a tribe and/or tribal members, therefore increasing competition
  - v. Particularly useful for development of Indian businesses not owned by a tribe or tribal enterprise and for tribal member consumers, where there is unequal bargaining or contracting power
  - vi. Harmonization with state laws may reduce the cost of transactions
- f. Examples of how tribal secured transaction laws would help tribal enterprises, Indian businesses, and Indian consumers
  - i. **Tribal enterprise**: A tribal enterprise seeks loans from several different lenders to build a tribal hospital complex and secures these loans with proceeds from its several manufacturing businesses and manufacturing equipment that it owns that are located in leased space off tribal land. Rather than recite in full the terms of these secured transactions in each loan agreement, a tribe with a secured transactions code could simply refer to the code in the agreements to address most loan terms. This would save legal costs, dramatically shorten agreements, and provide for the consistent application of tribal law to tribal transactions affecting tribal property
  - ii. **Tribal member-owned small business**: A member of the tribe seeks to start a trading post business on land held by him subject to federal restriction against alienation. He needs a \$20,000 loan to get started. The tribe to which he belongs cannot loan him money

for whatever reason. Because the tribe has a secured transaction code that provides that, in the event of default, a lender may use the tribal courts to take possession of the member's tractor and car, both of which he owns outright and which he uses to secure the loan, the lender agrees to make him the loan

- iii. **Tribal consumer**: A member of the tribe wants to use credit to buy a car from a car dealer off the reservation. In the past the dealer refused to sell cars (except for cash or subject to very high interest rates) to Indians who live on the reservation because he feared that once the car went to the reservation he could not recover the car from the reservation should the buyer fail to make car payments. Now that the tribe has a secured transactions code, the car dealer sells cars on credit to reservation Indians (and on favorable credit terms available to other members of the public) because the code provides ways in which the dealer can recover the car in the event he is not paid

### III. Secured Transaction Codes in Indian Country Today

- a. Fairly recent development
- b. Examples of tribal secured transactions codes in effect now
  - i. Comprehensive Tribal Commercial Codes
    - 1. Navajo Nation – comprehensive commercial code (1986)
    - 2. Sac and Fox Tribes – comprehensive commercial codes
  - ii. Indian Law Clinic, University of Montana, Model Tribal Secured Transaction Code – 1997  
([www.umt.edu/lawinsider/library/lawbysub/ucc.htm](http://www.umt.edu/lawinsider/library/lawbysub/ucc.htm))
    - 1. Hoopa Valley Tribe and Northern Cheyenne Tribe and others have adopted with modifications
    - 2. Based largely on UCC Article 9 before its recent revision and modified to address tribal needs and concerns
  - iii. Tribe adopts model UCC – incorporation by reference  
Eastern Band of Cherokee Indians, limited to TCGE Refinancing Transaction  
([www.narf.org/nill/Codes/ebcicode/eccodech16dgamingord.htm](http://www.narf.org/nill/Codes/ebcicode/eccodech16dgamingord.htm))
  - iv. Tribe adopts state UCC – incorporation by reference
    - 1. Little River Band of Ottawa Indians, limited to Little River Casino Resort Expansion Project – State of Michigan UCC  
([www.narf.org/nill/Codes/Ircode8.htm](http://www.narf.org/nill/Codes/Ircode8.htm))
    - 2. Cheyenne River – compact with State of South Dakota
    - 3. Mashantucket Pequot Tribal Nation – State of Connecticut UCC
  - v. Tribal Collection Codes - for sole purpose of providing rules for enforcement of judgments  
Oglala Sioux Tribe ([www.narf.org/nill/Codes/oglalacode/chapter02-civilactions.htm](http://www.narf.org/nill/Codes/oglalacode/chapter02-civilactions.htm))
  - vi. Problems with tribes adopting secured transactions laws from other jurisdictions or a model code

1. Incorporation of state law, even with carve-outs, may impose unintended and inappropriate legal rules due to the all-inclusive incorporation of other law into the state law and invite application of changes by the state in the law that are neither intended by nor desirable for tribe. Similar problems with wholesale incorporation of UCC Article 9
2. Many tribally drafted codes are based on old Article 9 – may encounter issues with lack of harmonization; no revision process benefit
3. Collection code approach is incomplete

#### IV. Components of Secured Transactions

- a. Creation and attachment of security interests in collateral
  - i. A security interest is an interest held by a creditor in *personal property or fixtures* to secure payment or performance of an obligation.
  - ii. Security interest is a *consensual* “lien” created by agreement of the parties
  - iii. Attachment – the point at which the security interest in collateral (or proceeds if the original collateral has been disposed of) becomes enforceable against the debtor
- b. Types of personal property that can be used as collateral
  - i. *Goods* - inventory; equipment; consumer goods; farm products (including crops, livestock and farm supplies); oil, gas, and other minerals after extraction from the land
  - ii. *Fixtures* – goods attached to real property but that retain value if removed - e.g., furnace, waterheater
  - iii. *Intangible property* - e.g., accounts receivable, licensed intellectual property rights
  - iv. *Payment instruments and similar writings* – e.g., the right to collect a promissory note or draft, the right to receive goods held in storage under a warehouse receipt, an equity interest in a corporation represented by a certificate
  - v. *Proceeds* – property received by a debtor upon the sale or exchange of property subject to a security interest (e.g., cash received for the sale of equipment, the right to collect from a credit buyer of inventory)
- c. Perfection of a security interest
  - i. A security interest must be perfected to make the interest enforceable against third parties
  - ii. The process to perfect an interest is designed to put third parties on notice of the existence of the security interest
  - iii. Perfection is critical if the debtor files for relief in bankruptcy. A security interest will be invalidated if it is not perfected prior to bankruptcy filing or, in some instances, if it is perfected so close to the time bankruptcy begins that it gives the secured creditor an unfair advantage over unsecured creditors.
  - iv. Basic ways of perfecting, depending on type of collateral, include

1. Taking possession of the collateral
  2. filing a notice of the security interest in public records (useful if debtor retains possession of the collateral)
- d. Priorities among creditors with interests in the same collateral
    - i. Objective of creditor taking a security interest in collateral is to ensure the interest is enforceable not only against the debtor but also against other parties that may obtain interests in the same property.
    - ii. The code provides the rules that establish the order in which competing creditors have rights in the same collateral
    - iii. General rule: Perfected secured party beats third parties (if multiple secured parties, first to file or perfect wins). There are appropriate exceptions – e.g., buyer of inventory from store doesn't have to worry about seller's lender
  - e. Filing as a means of public notice of security interests
    - i. A filing or registry system is the mechanism for putting the public on notice of security interests
    - ii. Filing systems should be convenient, accurate, and easy to access
    - iii. Most states house their filing systems in their respective Secretary of State offices
    - iv. Financing statement – the short document that is filed. It provides name of debtor, name of creditor and describes the collateral subject to a security interest
    - v. There are simple processes for continuing, terminating, and otherwise amending financing statements
  - f. Default and enforcement rules
    - i. There are rights and responsibilities placed on both creditors and debtors, designed to ensure fairness
    - ii. Special consumer protections
    - iii. In the event a debtor defaults, a creditor must be allowed to exercise its rights against the collateral, subject to procedural safeguards for the debtor

## **V. NCCUSL Committee on Liaison with Native American Tribes**

- a. A committee of the body that drafted the UCC, NCCUSL, is drafting a Tribal Secured Transaction Code
  - i. In drafting process, expected to be completed by year end 2004
  - ii. Based on revised Article 9, with some components of Article 1, 2, 8
  - iii. Modified to address tribal needs and concerns
  - iv. Revision process benefit
  - v. Implementation Guide
- b. Members of the NCCUSL Committee are experts in secured transactions law but none are experts in Indian Country matters.
- c. Special tribal considerations - examples
  - i. Fixtures (personal property that, once affixed to land, becomes real property; this is an issue where trust land or other land restricted against alienation is involved)

- ii. Filing systems (will tribe have its own system, “piggy-back” on state system, or form a cooperative system with other tribes?)
  - iii. Sovereign immunity (i.e., limited waivers)
  - iv. Manufactured homes
  - v. Ability to vary by agreement
  - vi. Lack of other tribal law to reference
  - vii. Consignments
  - viii. Scope of code – will it apply to transactions within the tribe?
  - ix. Per capita distributions – exclude from eligible collateral?
  - x. Self-help remedies (make available or not?)
  - xi. Choice of law and choice of venue issues
  - xii. Implication of tribal liens
  - xiii. Role of tribal custom and tradition
- d. Other Needs
- i. Court systems
    - 1. independent (separation of powers), impartial (must be perceived as fair)
    - 2. competent to adjudicate complex commercial cases
  - ii. Coordination with other law – does tribe have rules of civil procedure, rules of evidence, appellate procedures, etc.?
  - iii. Publication of laws and decisions – must be freely accessible to public
  - iv. Education (tribal judges; tribal attorneys; business, economic development and housing reps)
  - v. Filing Systems

*Contact:*

**Sue Woodrow**

**Federal Reserve Bank of Minneapolis**

**Helena, Montana Branch**

**(406) 447-3806**

[susan.woodrow@mpls.frb.org](mailto:susan.woodrow@mpls.frb.org)